Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
Special Access Rates for Price Cap Local Exchange Carriers	)	WC Docket No. 05-25
	)	
	)	
AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services	)	RM-10593
	)	
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COMMENTS OF THE NEW JERSEY DIVISION OF RATE COUNSEL

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I. INTRODUCTION

On July 9, 2007, the Federal Communications Commission ("FCC" or "Commission") released a Public Notice asking parties to "refresh the record" in the Commission's Special Access proceeding.[1] The New Jersey Division of Rate Counsel ("Rate Counsel") submits these comments in response to the Public Notice. Rate

[1] / Federal Communications Commission, Public Notice, "Parties Asked to Refresh Record in the Special Access Notice of Proposed Rulemaking," WC Docket No. 05-25, RM-10593, FCC 07-123, released July 9, 2007 ("Public Notice"); See, also, Fed. Reg. Vol. 42 No. 142, 40814 establishing comment date of August 8, 2007 and reply comment date of August 15, 2007.

Counsel filed initial comments on June 13, 2005 and reply comments on July 29, 2005[2] in response to the FCC's *Special Access NPRM*.[3]

A. INTEREST OF THE RATE COUNSEL IN THE INSTANT PROCEEDING.

The Rate Counsel is an independent New Jersey State agency that represents and protects the interests of all utility consumers, including residential, business, commercial, and industrial entities.[4] The Rate Counsel participates actively in relevant Federal and state administrative and judicial proceedings. The above-captioned proceeding is germane to the Rate Counsel's continued participation and interest in implementation of

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[2] / In the Matter of Special Access Rates for Price Cap Local Exchange Carriers; AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services, FCC WC Docket No. 05-25; RM-10593, Comments of the New Jersey Division of the Ratepayer Advocate, June 13, 2005 and Reply Comments of the New Jersey Division of the Ratepayer Advocate, July 29, 2005.

[3] / In the Matter of Special Access Rates for Price Cap Local Exchange Carriers; AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services, FCC WC Docket No. 05-25; RM-10593, Order and Notice of Proposed Rulemaking, released June 28, 2005 ("Special Access NPRM").

[4] / Effective July 1, 2006, the New Jersey Division of the Ratepayer Advocate is now Rate Counsel. The office of Rate Counsel is a Division within the New Jersey Department of the Public Advocate. The Department of the Public Advocate is a government agency that gives a voice to New Jersey citizens who often lack adequate representation in our political system. The Department of the Public Advocate was originally established in 1974, but it was abolished by the New Jersey State Legislature and New Jersey Governor Whitman in 1994. The Division of the Ratepayer Advocate was established in 1994 through enactment of Governor Whitman's Reorganization Plan. See New Jersey Reorganization Plan 001-1994, codified at N.J.S.A. 13:1D-1, et seq. The mission of the Ratepayer Advocate was to make sure that all classes of utility consumers receive safe, adequate and proper utility service at affordable rates that were just and nondiscriminatory. In addition, the Ratepayer Advocate worked to insure that all consumers were knowledgeable about the choices they had in the emerging age of utility competition. The Department of the Public Advocate was reconstituted as a principal executive department of the State on January 17, 2006, pursuant to the Public Advocate Restoration Act of 2005, P.L. 2005, c. 155 (N.J.S.A. §§ 52:27EE-1 et seq.). The Department is authorized by statute to "represent the public interest in such administrative and court proceedings … as the Public Advocate deems shall best serve the public interest," N.J.S.A. § 52:"27EE-57, i.e., an "interest or right arising from the Constitution, decisions of court, common law or other laws of the United States or of this State inhering in the citizens of this State or in a broad class of such citizens." N.J.S.A.§52:27EE-12; The Division of Rate Counsel, formerly known as the Ratepayer Advocate, became a division therein to continue its mission of protecting New Jersey ratepayers in utility matters. The Division of Rate Counsel represents and protects the interests of all utility consumers, including residential, business, commercial, and industrial entities. Rate Counsel participates in Federal and state administrative and judicial proceedings.

the Telecommunications Act of 1996. The New Jersey Legislature has declared that it is the policy of the State to provide diversity in the supply of telecommunications services, and it has found that competition will "promote efficiency, reduce regulatory delay, and foster productivity and innovation" and "produce a wider selection of services at competitive market-based prices." The resolution of the complex economic and policy issues that this proceeding embraces directly affects the structure of telecommunications markets, and the prices that consumers pay for basic telecommunications service.

In its *Special Access NPRM*, the Commission commenced an examination of the framework under which price cap local exchange carriers ("LECs") provide interstate special access services.[5] As such, the Commission sought comments regarding the special access regulatory regime including whether the Commission should maintain, modify, or repeal its current pricing flexibility rules.[6] The Commission observed that special access services have gained in importance relative to other access services to such a degree that a separate examination of a single interstate access charge basket is justified.[7] The *Special Access NPRM* encompasses various issues including, but not limited to "traditional price cap issues" and the current pricing flexibility rules. The outcome of this proceeding will affect competition in access markets, and ultimately, consumers. Rate Counsel urges the Commission to consider the impact of a new

[5] / The Commission sought comment on the regime that should replace the CALLS plan originally set to expire on June 30, 2005. In the Matter of Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Low-Volume Long Distance Users; Federal-State Joint Board On Universal Service, CC Docket Nos. 96-262; 94-1; 99-249; 96-45; Sixth Report and Order in CC Docket Nos. 96-262 and 94-1; Report and Order in CC Docket No. 96-45, released May 31, 2000 ("CALLS Order"). The Commission continued the CALLS plan until it adopts a subsequent plan. Special Access NPRM, at para. 2.

[6] / *Special Access NPRM*, at paras. 1, 5.

[7] / *Id.*, at para. 3.

framework for the regulation of special access services on residential and small business consumers, rates for basic services, rural consumers, and low-volume users.

B. SCOPE OF THE SPECIAL ACCESS NPRM AND PUBLIC NOTICE.

The *Special Access NPRM* sought comment on numerous issues related to the price cap regulatory regime and pricing flexibility. Price cap issues for which the Commission sought comments include such topics as the price cap index ("PCI") formula, the productivity or X-factor, the growth or "g" factor, earnings sharing, the low-end adjustment, special access services basket categories and subcategories, and rate reinitialization.[8] The Commission sought comment about its pricing flexibility rules and regarding the assessment of competition in the special access market, the relevant product and geographic markets, demand and supply responsiveness and market share, and barriers to entry.[9] Finally, the Commission sought input on the relationship between the price cap regulatory regime and pricing flexibility rules.[10]

In its recent Public Notice, which it released almost two years after reply comments were filed in this proceeding, the Commission cites several developments in the industry "that may have affected parties' positions on the issues raised in the *Special Access NPRM*."[11] The developments cited by the Commission include:

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[8]/ *Id.*, at paras. 30-68.

[9]/ *Id.*, at paras. 69-125.

[10]/ *Id.*, at paras. 126-127.

[11] / Public Notice, at 1.

- Several "significant mergers" and "industry consolidations;[12]
- The "continued expansion" of intermodal competition;[13] and
- The release of the U.S. Government Accountability Office's ("GAO") report on the special access services market in November of 2006.[14]

The Commission asks parties to refresh the record based upon those developments and also seeks comments on additional questions that the Commission originally did not include in the *Special Access NPRM*. The additional questions include:

- The effect of industry consolidation on the availability of competitive special access facilities and providers;
- How special access pricing affects the price and availability of wireless services and investment in wireless network deployment;
- The methods used to estimate costs of upgrades to special access facilities;
- Whether the Commission should subdivide optical fiber services into low capacity OCn services and high capacity OCn services; and
- Analysis of the GAO's special access report.[15]

C. SUMMARY OF COMMENTS

Rate Counsel commends the Commission for focusing yet again on this issue of far-reaching importance to all stakeholders. The Commission has repeatedly punted on

[12] / Public Notice, at 1, citing the mergers of AT&T and BellSouth (WC Dkt. No. 06-74); SBC and AT&T (WC Dkt. No. 05-65); Verizon and MCI (WC Dkt No. 05-75); and the acquisition of Looking Glass Networks by Level 3 (WC Dkt. No. 06-116).

[13] / Public Notice, at 1-2.

[14] / Id., at 2, citing Government Accountability Office, FCC Needs to Improve its Ability to Monitor and Determine the Extent of Competition in Dedicated Access Services, Report 07-80 (Nov. 2006) ("GAO Report").

[15] / *Id.*, at 2-3.

special access over the past several years and it is critically important that a resolution is achieved. As acknowledged by the Commission in its *Special Access NPRM*, special access services are a key input in the service offerings provided to consumers by business customers, wireless carriers, interexchange carriers, and competitive local exchange providers.[16] The Rate Counsel stated the following in reply comments in this proceeding in 2005:

Many commenters in this proceeding have submitted evidence to the Commission that the special access market is not competitive and that the price cap LECs are able to exercise market power. Furthermore, the demise of unbundled network element – platform ("UNE-P") and the disappearance of the two largest special access competitors do not bode well for the future of competition in the special access market. As such, the Commission should take great care in examining its current price cap regime for special access services and pricing flexibility rules. The evidence suggests that the Commission should, at a minimum, place a moratorium on grants of Phase II pricing flexibility and repeal such grants until the Commission has undertaken a comprehensive review of the market and made a determination as to the best regulatory regime. Such a review is critical to the development of competition in the special access market.[17]

Rate Counsel remains concerned about the evidence of anticompetitive contracts and discount plans previously presented in this proceeding.[18] In addition, Rate Counsel and others have provided ample evidence that pricing flexibility triggers are too broad, are based on potential (as opposed to actual) competition, and do not provide an accurate

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[16] / Special Access NPRM, at para. 3.

[17] / Rate Counsel reply comments, July 29, 2007, at 2-3.

[18] / *Id.*, at 20-22

picture of competition in the access market.[19] Rate Counsel submits that there is overwhelmingly evidence already in the record regarding these concerns and will not repeat those arguments in these comments.

Rate Counsel reiterates its support for the re-initialization of special access rates. In reply comments, Rate Counsel stated:

The Ratepayer Advocate concurs with ATX et al's recommendation that the FCC re-initialize rates based on forward-looking economic cost, using the TELRIC-based UNE rates that states have established. The use of forward-looking costs will yield accurate pricing signals and avoid the pitfalls of ARMIS data that various parties have identified. At the same time, the Commission should determine whether prices would be lower under rate of return than under price cap regulation. This is a necessary predicate for any reasoned decision. [20]

II. RATE COUNSEL URGES THE COMMISSION TO EXAMINE THE EVIDENCE THAT IS ALREADY IN THE RECORD AND THAT DEMONSTRATES THAT THE SPECIAL ACCESS MARKET IS NOT COMPETITIVE.

The evidence in this proceeding demonstrates that the special access market is not competitive and that the price cap LECs are able to exercise market power. The future for competition in the special access market is less certain than in the past given the discontinuation of access to UNE-P and the mergers of two Bell operating companies with their two largest special access competitors. Rate Counsel intends to examine the data and evidence that CLECs may submit regarding their experience obtaining special access services in the wake of major industry consolidation and concentration. As stated

[19] / *Id.*, at 22-27.

[20] / *Id.,* (see generally, *id.*, at 28-42), note omitted.

in Rate Counsel's reply comments in July 2005, the Commission should "consider, instead, undertaking a comprehensive review of the present state of competition in the industry and the legality of the contracts under which services are provided before determining the type of regulation under which ILECs offering special access services should operate."[21] Rate Counsel continues to support a "roll-back" of Phase II pricing flexibility at least until a more nuanced set of guidelines and triggers can be adopted that accurately reflect the real, as opposed to potential, competition in the special access market and on a realistic geographic market basis.[22] Numerous commenters have presented evidence demonstrating that the special access market is not competitive.[23]

As acknowledged by the Commission, the BOCs have been earning special access accounting rates of return substantially in excess of the prescribed 11.25% rate of return that applies to rate of return LECs.[24] In 2005, various commenters provided evidence that the RBOCs achieve supracompetitive rates of return thus casting doubt on the purported competitiveness of the market.[25] Later in these comments, Rate Counsel provides more current data.

In filings to the FCC regarding its review of the proposed merger of AT&T and BellSouth, AT&T and BellSouth blamed the frozen level of separations for the seemingly

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[21] / *Id.*, at 1-2.

[22] / *Id.*, at 2.

[23] / See, e.g., Wiltel Communications, LLC initial comments, June 13, 2005, at 2, 9; CompTel/ALTS, Global Crossing North America, Inc. and NuVox Communications ("CompTel/ALTS") initial comments, June 13, 2005, at i, 2; ATX Communications Services, Inc., BridgeCom International, Inc., Broadview Networks, Inc., Pac-West Telecom, Inc., US LEC Corp., and U.S. Telepacific Corp. d/b/a Telepacific Communications ("ATX et al") initial comments, June 13, 2005, at 5; Time Warner Telecom ("Time Warner") initial comments, June 13, 2006, at 6; Ad Hoc Telecommunications Users Committee ("Ad Hoc") initial comments, June 13, 2006, at 3, 8-9.

[24] / Special Access NPRM, at para. 35.

[25] / See, e.g., ATX et al, June 13, 2005, at 7; Ad Hoc, Declaration of Susan M. Gately, at para. 9.

exorbitant returns the RBOCs report from special access. A reply declaration submitted by AT&T and BellSouth in their merger proceeding observes that the "FCC's cost allocation rules relating to these services are based on cost studies from the late 1990s and have been frozen since 2001. Since that time, however, there has been a substantial divergence in demand for special access and switched access revenues."[26] The declaration also quotes comments filed by legacy SBC in a different proceeding stating, among other things:

> ARMIS results . . . understate the costs an ILEC incurs to provide any service that has experienced significant growth in volumes. The costs for interstate special access services are particularly susceptible to this understatement because demand has increased dramatically over the past several years with the explosive growth in data services. The result is a mismatch between costs which do not properly reflect current utilization and volumes and revenues which do. This mismatch, of course, will overstate the calculated rate of return.[27]

The ILECs are positing inconsistent views. In one proceeding, industry members acknowledge the cost-revenue mismatch arising from the explosive growth in data services as a way to "excuse" high interstate rates of return,[28] and in other proceedings, seek to preclude states from correcting this mismatch. The consequence of these two simultaneous industry arguments, if unaddressed by regulators, would be exorbitant *interstate* special access rates and excessive *intrastate* regulated rates. The purpose of

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[26] / *In the Matter of AT&T Inc. and BellSouth Corporation Applications for Approval of Transfer of Control*, WC Docket No. 06-74, Reply Declaration of Dennis W. Carlton and Hal S. Sider, June 19, 2006, at para. 30.

[27] / *Id.,* at para. 32, quoting comments of David Toti, then the Executive Director – Regulatory Accounting for SBC.

[28] / In the Matter of Special Access Rates for Price Cap Local Exchange Carriers, WC Docket No. 05-25; AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services, RM-10593, Comments of Qwest Communications International, Inc., June 13, 2005, at 4, 11; Comments of the United States Telecom Association, June 13, 2005, at 11-13; Comments of Verizon, June 13, 2005, at 21.

separations is to prevent incumbent LECs from recovering the same costs in both the interstate and intrastate jurisdictions. The industry is gaming the process to avoid lowering either interstate or intrastate rates. The Commission should consider the relationship of its separations and special access proceedings in order to develop a coherent policy and decision on these two critically important matters. As Rate Counsel (as part of joint comments with the National Association of State Utility Consumer Advocates ("NASUCA") and the Maine Office of the Public Advocate) stated in reply comments in the FCC's separations proceeding:

> Initial comments echo the State Consumer Advocates' concern about carriers' failure to assign the increasing quantities of interstate private lines to the interstate jurisdiction. The Wisconsin PSC states that, since the 2001 freeze, costs related to special access and private lines have been improperly intermingled with common line expenses. The Wisconsin PSC cites as evidence the supra-normal profits earned by numerous ILECs for their special access service: Out of 80 companies reporting, 55 had returns on investment in excess of 60%. Describing this as "supra-normal" certainly strains the meaning of "normal." "Mind-boggling" would seem to fit more accurately, and it should take nothing more than this one fact to convince a disinterested observer that there is something seriously amiss in the separations regime, which needs fixed [sic] for the protection of consumers and competition.[29]

Commenters in 2005 also provided overwhelming evidence demonstrating that where pricing flexibility has been granted, special access prices have increased, thus calling into question the Commission's earlier determination that competition existed.[30] Rate Counsel repeats its statement from 2005:

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[29] / *In the Matter of Jurisdictional Separations and Referral to the Federal-State Joint Board*, FCC CC Docket No. 80-286, Reply Comments of The National Association of State Utility Consumer Advocates. The New Jersey Division of Rate Counsel, and the Maine Office of Public Advocate, November 20, 2006, at page 34-35.

[30] / Sprint initial comments June 13, 2005, at 2-5; Wiltel initial comments June 13, 2005, at 21-22; Ad Hoc initial comments June 13, 2005, at 16-24; Comptel/ALTS initial comments June 13, 2005, at 6; Time Warner initial comments June 13, 2005, at 17-18.

> The record regarding price increases where pricing flexibility has been granted is compelling and has been submitted time and again in several proceedings over the past several years. The Commission's request for more recent data to demonstrate that such price increases are "substantial and sustained" has been answered. The Ratepayer Advocate urges the Commission to seriously examine the evidence and to consider the ramifications to competition, and ultimately, to consumers if grants of pricing flexibility continue in markets that are not fully competitive.[31]

A recent *ex parte* presentation filed electronically with the Commission indicates that prices remain high in "competitive" areas.[32] It is imperative that the Commission undertake a comprehensive review of competitive conditions in the special access market before it adopts a new framework to govern the regulation of the special access market. As the Rate Counsel stated previously: "consumers need immediate relief from the price cap LECs' anticompetitive pricing and contract practices. As such, the Commission should repeal Phase II flexibility until such a comprehensive investigation has been completed."[33]

III. INDUSTRY CONSOLIDATION

In anticipation of the mergers of Verizon with MCI and SBC with AT&T, Rate Counsel stated the following in its reply comments in 2005:

AT&T's and MCI's decisions to merge rather than compete with their long-standing rivals undermine the RBOCs' contentions that special access markets are competitive. That these two CLECs would throw in the towel provides compelling evidence about the difficulty of entering and surviving in BOC-dominated markets.

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[31] / Rate Counsel reply comments, July 29, 2005, at 14, footnotes omitted.

[32] / See,also, Ex Parte Notice Letter from Karen Reidy, CompTel, to Marlene H. Dortch, Secretary, Federal Communications Commission, Re: WC Docket No. 05-25; RM-10593: and WC Docket No. 06-125, August 1, 2007, Attached presentation "Meeting with John Hunter, 8/1/2007."

[33]/ Rate Counsel reply comments, July 29, 2005, at footnote 8.

These two pending mega-mergers would concentrate special access markets substantially and diminish consumers' options for competitive choice. The Ratepayer Advocate urges the Commission to establish a regulatory framework for special access that recognizes and addresses the fundamental imperfections that exist in today's market place. Should the competition that the BOCs erroneously contend exists actually develop, the Commission can modify the regulatory framework accordingly.[34]

Comments subsequently submitted in the AT&T/BellSouth merger proceeding indicate that competitors had concerns about the market power of the LECs, as a result of their experiences of the prior ILEC/IXC mega-mergers. Wireless carriers, wireline CLECs and cable companies all provided evidence of the potential for anticompetitive behavior on the part of ILECs and on increasing concentration in the special access services market:

> Sprint Nextel, Mobile Satellite Ventures, and Comptel, for example, highlight wireless providers' reliance on special access services and the potential for anticompetitive behavior on the part of AT&T, as the parent of Cingular. Global Crossing expresses concern regarding increasing concentration in the special access market, stating "[t]his concentration, combined with increasing pricing flexibility, raise serious concerns regard AT&T/BellSouth's pricing power and willingness to deal." Paetec Communications, Inc. ("Paetec") asserts that it depends upon ILEC special access connections for 95% of its "last-mile connections to end-users." Paetec expresses concerns regarding the interoffice transport market in addition to the high capacity loop market and asserts that the "competitive situation in the special access market" in AT&T's and Verizon's territory has "deteriorated substantially" since the mergers. Fones4All provided evidence in the form of several ex parte filings with the Commission that AT&T is discriminating against competitors. Time Warner includes significant amounts of proprietary information about its business, which demonstrate its significant dependence on the Applicants' wholesale inputs (loops, etc.). Time Warner demonstrates

[34] / *Id.*, at 11.

> comprehensively that it relies on ILEC inputs to serve many customer locations.[35]

Indeed, as Commissioner Copps explained in his statement concerning the AT&T/BellSouth merger:

> Finally, before accumulating enormous additional market power in the special access market, the company should address the well documented concern that businesses are being charged inflated prices for high-volume voice and data services—behavior that retards small business growth, inhibits America's international competitive posture, and eventually trickles down to consumers in higher costs.[36]

The fact that the special access conditions of the AT&T and BellSouth merger are more comprehensive than those for the Verizon/MCI merger underscores the vulnerability of consumers and competitors to increasing market concentration in New Jersey. Furthermore, Verizon Communications, Inc. has publicly stated that it will not lower its special access prices in response to the conditions adopted as part of the AT&T/BellSouth merger approval.[37] Commissioner Adelstein discusses the special access conditions adopted as part of the Commission's approval of the AT&T/BellSouth merger in the following terms:

> *Special Access Services*. It is clear that many business customers and wholesale carriers rely heavily on the applicants' special access services for their voice and high-speed connections. Independent wireless companies, satellite providers, and long distance providers also depend on

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[35] / See *In the Matter of AT&T Inc. and BellSouth Corporation Applications for Approval of Transfer of Control*, WC Docket No. 06-74, Reply Comments of the New Jersey Division of the Ratepayer Advocate, June 20, 2006, at 18-19, citing Comptel, at 7; Time Warner, at 3-4, Access Point et al., at 7-13; Sprint Nextel, at 9-11; Mobile Satellite Ventures, at 3; Global Crossing, at 3-4; Paetec, at ii, 5-6; Fones4All, at 10; Time Warner, Declaration of Graham Taylor.

[36] / Statement of Commissioner Michael J. Copps, Concurring, *In the Matter of AT&T and BellSouth Corporation Application for Transfer of Control*, WC Docket No. 06-74, December 29, 2006 ("Copps Statement on AT&T/BellSouth merger"), at 2.

[37] / *TR Daily*, "Verizon Says It Will Not Cut Special Access Services Prices," January 4, 2007. Verizon and Qwest will not qualify for lower AT&T wholesale special access prices for DS1, DS3, and Ethernet services if they do not lower rates in their incumbent regions as well. Verizon asserts that their prices "are already at competitive levels." *Id.*

> access to the applicants' nearly ubiquitous network and services to connect their networks to other carriers. In addition, many small rural providers depend on these services to connect to the Internet backbone. So, if the applicants were to raise prices as a result of diminished competition, such action would directly impact the cost and availability of services for large and small businesses, schools, hospitals, government offices, and independent wireless providers. Particularly in light of DOJ's inaction, I believe it is imperative to adopt measures to protect against the loss of competition. The Order includes modest provisions to reduce the applicants' prices for special access services in areas where the Government Accountability Office (GAO), in its recent report on special access services, raised the most significant concern, and the Order includes a price freeze for the remainder of the applicant's special access services across the entire 22 state territory of the new company.
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> The Order also addresses some of the terms and conditions that have been called into question by GAO. For example, it eliminates on a going forward basis at least one condition that restricts the ability of wholesale providers to buy from other channels. While I would have supported, and many commenters have strongly urged the Commission to adopt, more stringent safeguards in this area, we have attempted to provide a modest level of stability for 48 months for these many consumers of special access services. I do note that the Commission has a long-pending proceeding on special access services and, with fresh motivation from GAO's report, it will be even more critical that the Commission tackle these issues as comprehensively and expeditiously as possible. I will continue to push for action on this long-overdue proceeding. [38]

As a result of the less effective FCC conditions applicable to the Verizon/MCI merger, Verizon NJ is able to exercise its market power easily to continue to extract supracompetitive profits in its interstate and intrastate special access and private line rates from businesses in New Jersey. Rate Counsel urges the FCC to address this market imperfection in a timely manner.

[38] / Statement of Commissioner Jonathan S. Adelstein, Concurring, *In the Matter of AT&T and BellSouth Corporation Application for Transfer of Control*, WC Docket No. 06-74, December 29, 2006, rel. March 26, 2007 ("Adelstein Statement on AT&T/BellSouth merger"), at 5-6.

IV. INTERMODAL COMPETITION DOES NOT ENHANCE COMPETITION IN THE SPECIAL ACCESS SERVICES MARKET, AND, IN FACT, BOCS NOW COMPETE WITH THEIR SPECIAL ACCESS CUSTOMERS.

In its Public Notice, the Commission highlights the "continued expansion" of intermodal competition as a development in the industry that may have affected parties' positions. Indeed, it appears that many intermodal services rely upon the special access services provided by the BOCs. As described above, many of the intermodal providers themselves have described the extent to which the provision of their services relies upon the ILECs' special access services. A recent *ex parte* filed by CompTel describes the changes in the industry aptly by noting that where once the special access marketplace was a "collection of end-to-end services" it is now "a crucial input for other products and services" and "a powerful competitive weapon."[39]

The Commission acknowledges in its Public Notice that "special access has been an important input for" wireless voice and broadband services.[40] As Rate Counsel stated in its reply comments in the Commission's broadband deployment proceeding (GN Dkt. 07-45):

> Rate Counsel recommends that the Commission address Sprint Nextel's concern about the dampening effect of high special access rates on broadband deployment goals. As explained by Sprint Nextel, wireless carriers rely on ILECs' special access services to connect their cell towers to their switches and to ILECs' networks. Rate Counsel concurs with Sprint Nextel that Commission examination of ILECs' special access rates and profits is long overdue. Accurate pricing signals for ILECs' non-competitive special access circuits is essential to permit the economically efficient development of a multi-modal ubiquitous advanced telecommunications network. Artificially high special access rates are

[39] / Ex Parte Notice Letter from Karen Reidy, CompTel, to Marlene H. Dortch, Secretary, Federal Communications Commission, Re: WC Docket No. 05-25; RM-10593: and WC Docket No. 06-125, August 1, 2007, Attached presentation "Meeting with John Hunter, 8/1/2007."

[40] / Public Notice, at 2.

jeopardizing the Commission's ability to achieve its broadband deployment goals.[41]

V. THE GAO REPORT

The Commission should give the GAO report summarizing its review of the special access services market proper weight.[42] The GAO report concludes that less than 6% of buildings with at least a DS-1 level of demand for special access services have a competitive alternative other than the incumbent LEC.[43] The GAO also found after reviewing data from the FCC and the four major price cap incumbents that "prices and average revenues are higher, on average, in phase II MSAs – where competition is theoretically more rigorous – than they are in phase I MSAs or in areas where prices are still constrained by the price cap."[44] The report further concluded that the FCC failed to monitor market deregulatiom and that in order "to better meet its regulatory responsibilities" it should "collect more meaningful data" and also "needs a more accurate measure of competition."[45] The report provides further support for Rate Counsel and others' position that the Commission should focus first on a comprehensive examination of whether, and to what extent, competition exists in the special access market.

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[41] / Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion, and Possible Steps to Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996, FCC GN Docket No. 07-45, Reply Comments of the New Jersey Division of Rate Counsel, May 31, 2007, at 14.

[42] / Public Notice, at 2.

[43] / United States Government Accountability Office, Report to the Chairman, Committee on Government Reform, House of Representatives, *FCC Needs to Improve Its Ability to Monitor and Determine the Extent of Competition in Dedicated Access Services*, GAO-07-80, November 2006, at 12.

[44] / *Id.*, at 13.

[45] / *Id.*, at 15.

VI. UPDATED DATA/EVIDENCE

The exorbitant and increasing rates of return that Bell operating companies are earning provide compelling evidence of their unconstrained market power and the need for timely regulatory oversight. As Table 1 shows, nationwide, the rate of return for the Bell operating companies' special access services increased from approximately 38% in 2001 to approximately 78% in 2006.[46] Furthermore, as reported in the ARMIS data, the earnings are after taxes, which means that if the earnings were reported before taxes, they would be even higher.[47] Table 1 also shows that throughout its footprint, Verizon's rate of return increased from 22.3% in 2001 to more than 50% in 2006.

Table 1[48]

RBOCs' Special Access Rates of Return Continue to Increase

Year	AT&T	Qwest	Verizon	All RBOCs
2001	56.2%	44.7%	22.3%	38.2%
2002	54.1%	57.7%	24.1%	39.7%
2003	63.2%	65.8%	23.1%	42.9%
2004	76.2%	75.1%	31.6%	52.8%
2005	94.1%	109.4%	42.0%	68.2%
2006	99.6%	132.2%	51.8%	77.9%

Source: Federal Communications Commission, ARMIS Report 43-04, Table I, data run 8/6/2007.

[46] / See, also, Ex Parte Notice Letter from Karen Reidy, CompTel, to Marlene H. Dortch, Secretary, Federal Communications Commission, Re: WC Docket No. 05-25; RM-10593: and WC Docket No. 06-125, August 1, 2007, Attached presentation "Meeting with John Hunter, 8/1/2007." CompTel provides evidence that BOC rates of return continue to increase.

[47] / See http://www.fcc.gov/wcb/armis/instructions/2006/definitions04.htm#T1R; Row 8030 corresponds with "Total Operating Taxes", and Row 8041, which is net return, is net of, among other things, Row 8030.

[48] / Data for BellSouth are combined with those of AT&T for the years 2001 through 2006 to correspond with ARMIS reporting. AT&T and BellSouth merged on December 29, 2006. "AT&T and BellSouth Join to Create a Premier Global Communications Company," December 29, 2006, www.att.com.

The Commission's delay in correcting Bell operating companies' supracompetitive rates of return for their interstate special access services harms the development of competition, the deployment of broadband alternatives, and consumers in New Jersey. As Table 2 shows, in New Jersey, Verizon's rate of return has increased from 26% in 2001 to 104% in 2006.

Table 2

Verizon New Jersey's Special Access Rate of Return

Provides Compelling Evidence of its Market Power

Year	Average Net Investment (ARMIS Row 8040)	Net Return (ARMIS ROW 8041)	Rate of Return (Row 8041/Row 8040)
2001	$ 633,274,000	$ 164,691,000	26%
2002	$ 612,437,000	$ 214,572,000	35%
2003	$ 511,166,000	$ 191,459,000	37%
2004	$ 435,648,000	$ 223,837,000	51%
2005	$ 352,473,000	$ 269,974,000	77%
2006	$ 321,981,000	$ 335,596,000	104%

Source: FCC ARMIS Report 43-04, Table 1. Separations and Access Data.
Data for Verizon New Jersey Special Access services.

VII. CONCLUSION

WHEREFORE the reasons set forth above the Ratepayer Advocate recommends that the Commission:

- Undertake a comprehensive review of the status of competition in the special access market; the extent to which BOCs now directly compete with their special access customers; and examine and respond to the findings of the GAO;
- Consider the impact of any proposed price cap regulatory regime and the pricing flexibility rules on residential and business consumers, particularly those with low volumes, in rural areas, and/or with low incomes;
- Adopt competitive triggers for pricing flexibility requests that measure actual, rather than potential competition or, in the alternative, repeal the pricing flexibility rules;
- Ensure that the contracts offering by ILECs for special access services are not anti-competitive or unlawful;
- Ensure that any supra-competitive profits and/or merger synergies are flowed through to consumers through both an earnings sharing mechanism and the productivity factor;
- If the available marketplace data confirms that the BOCs yield substantial market power in the special access market, the Commission should consider reinitializing special access rates and adopting rate of return regulation and an updated rate of return that applies to rate of return LECs; and/or
- Determine whether rates would be lower under rate of return regulation as compared to price cap regulation.

Respectfully submitted,

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